California Fair Political Practices Commission

MEMORANDUM

To:	Chairman Getman, Commissioners Downey, Knox, Scott, and Swanson
From:	William L. Williams, Jr., Staff Counsel John W. Wallace, Assistant General Counsel Luisa Menchaca, General Counsel
Subject:	Conflict of Interest Regulations Improvement Project- Discussion of Policy Issue Concerning Regulation 18707.4
Date:	October 23, 2001

INTRODUCTION

At last month's Commission meeting, staff presented a status report and several technical amendments to the conflict of interest regulations as a follow-up to the implementation of Phase 2 of the Conflict of Interest Regulations Improvement Project. Due to a need for further internal review of proposed amendments to Regulation 18707.4, staff reserved presentation of such proposed amendments to the November meeting. Upon this further internal review, it became apparent that there was a need for resolution of an underlying fundamental policy issue by the Commission before there could be any meaningful consideration of any specific amendments to the regulation. Accordingly, this memorandum will present this fundamental policy for the Commission's consideration and decision points for resolution.

ISSUE

What is the appropriate scope of the "public generally" exception for appointed boards and commissions?

BACKGROUND AND OVERVIEW

The Public Generally Exception for Appointed Boards and Commissions

As the Commission is aware, the "public generally" exception allows a public official who has a conflict of interest under the Act[1] to nonetheless participate in a governmental decision because the decision will affect the public official's economic interest in a manner that is indistinguishable from the effect on the public generally. The statutory foundation for this exception can be found in Government Code § 87103, which defines a "financial interest" for conflict of interest purposes, stating in part:

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1. Unless otherwise specified herein, all citations are to the Political Reform Act at Government Code sections 81000 – 91014. All regulatory citations are to Commission regulations at Title 2, sections 18109 – 18997, of the California Code of Regulations.

> "A public official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, **distinguishable from its effect on the public generally**, on the official, a member of his or her immediate family, or on any of the following…" [Emphasis added.]

The "public generally" exception is further delineated under the Commission's regulations. (Reg. 18707 et seq.)

A variant of the "public generally" exception for appointed boards and commissions is set forth in Regulation 18707.4. (See pp. 11-12, *infra*, for the full text of current Regulation 18707.4.) It allows members of certain types of boards and commissions, who have a statutorily acknowledged conflict of interest by virtue of the terms of their appointment, to still participate in decisions of the board or commission if others in their trade, industry, profession, or economic interest group would be affected in substantially the same way. The legislation giving rise to these types of commissions and boards varies, but is consistent in the sense that it envisions that the member will bring to the table certain levels of specialized knowledge and expertise, flowing from the member's economic interest, that will ultimately aid in the accomplishment of the body's statutory mission. However, the same economic interest that gives rise to the specialized knowledge and expertise, also gives rise to the conflict of interest. Because of the inherent conflict of interest in this type of legislation, a tension arises between accomplishing the oftentimes laudable purposes of the subject legislation and the purposes of the conflict of interest provisions of the Act in preventing self-interested economic enrichment in official decision-making.

Historical Perspective

Almost from the inception of the Act, the above discussed competing policy considerations have given rise to controversy for the Commission. In early 1976, the Commission adopted then Regulation 18703 embodying a form of the public generally exception for appointed boards and commissions stating in part as follows:

> "A ... financial effect ... is distinguishable from its effect on the public generally unless the decision will affect the official's interest in substantially the same manner as it will affect all members of the public or a significant segment of the public. Except as provided herein, an industry, trade or profession does not constitute a significant segment of the general public.
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> ¶…¶
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> "(c) An industry, trade or profession constitutes a significant segment of the public if the statute, ordinance or other provision of law which creates or authorizes the creation of the official's agency or office contains a finding and declaration, including an express reference to Section 87103 of the Government Code, [as provided herein]....

> "(d) Through January 1, 1979, an industry, trade or profession constitutes a significant segment of the public if the statute, ordinance or other provision of law which creates or authorizes the creation of the official's agency contains a requirement or express authorization that members of that industry, trade or profession hold such office...."

This regulation was expressly oriented towards regulatory boards for an industry, trade or profession (e.g. State Board of Funeral Directors and Embalmers). The validity of the regulation was immediately challenged in court by a consumer group. The main thrust of the suit was that the regulation, by allowing members of industry dominated boards and commissions to participate in decisions in which they had an economic interest, constituted an abrogation of the conflict of interest provisions of the Act. The regulation was held to be invalid by the trial court. The Commission appealed that ruling, obtaining a stay of the trial court order in the interim.

During the pendency of the appeal, a sharply divided Commission issued an opinion applying the regulation to a decision of the State Board of Funeral Directors and Embalmers. (*In re Callanan* (1978) 4 FPPC Ops. 33, a copy of which is attached as Appendix A.) In the *Callanan* Opinion, the majority discussed the "public generally" exception for appointed boards and commissions as follows:

> "The subsections [of Regulation 18703] were adopted in an effort to reconcile the conflict of interest provisions of the Political Reform Act with other statutes which require certain boards to include as members persons who represent the industry, trade or profession which the board oversees. The Commission was persuaded that when the legislative body which creates a regulatory board determines that industry views and expertise should be represented on the board, the Political Reform Act should not be interpreted to prevent industry members from participating in board decisions affecting the industry. Consequently, we believe that each industry board member should be allowed to vote on industry matters unless the decision in question would directly and peculiarly affect the members' financial interests in a manner different from its effect on all other members of the industry."

The majority went on to allow the participation of the traditional funeral director board members in a decision that had a distinct effect on them as compared with the cremation sector of the industry. Notably, the dissent, while not challenging the underlying premise of the regulation, was very concerned about what it perceived to be an overly broad application of the exception. Commissioner Quinn,[2] in dissenting stated:

> "By permitting the industry members to vote, the majority is saying that

2. Chairman Lowenstein also dissented, though less vigorously, finding that the majority was applying the exception in a overly broad manner.

the Act is to be applied differently to them simply because they sit as industry members on these regulatory boards. For other public officials to vote on matters where a personal financial interest is present, uniform impact on the public must be shown. Not so, however, for industry board members. They may vote even though we know that a conflict exists and they will be financially advantaged or disadvantaged differently from other members of their industry.

"This is not applying 2 Cal.Adm.Code Section 18703 as the Commission intended it be applied when it was adopted. Indeed the majority ought to change the regulation rather than pretend this interpretation is consistent with it. The regulation is already under severe attack in the Consumers Union case. [Footnote omitted.] This interpretation only further weakens it, and makes its ultimate survival, already precarious, that much more doubtful."

Shortly after the issuance of the *Callanan* opinion, the court of appeal ruled on the previously discussed facial challenge to the regulation in *Consumers Union of U.S., Inc.* v. *California Milk Producers Advisory Bd.* (1978) 82 Cal.App.3d 433, 447 [147 Cal.Rptr. 265]. (A copy of the decision is attached as Appendix B.) Upholding the regulation as a valid exercise of the Commission's rule-making authority the court stated:

"There are no specific definitions in the PRA of the phrases 'distinguishable from the public generally,' 'reasonably foreseeable,' or 'material financial effect.' The definitions of these phrases may have to be resolved through further litigation. [Citation.] The literal language of section 87103 is capable of the broad construction urged by the respondents. Some of the 1974 supporters of the PRA, no doubt, had hoped to make major revisions in the way government was to be run. Strong policy arguments may be made as to the desirability of eliminating, or severely restricting, industry members from boards, despite the claim that industry boards promote higher standards for the industry and thus serve the public. There are meritorious arguments that many industry-dominated boards do not adequately serve consumers' interests.

"The FPPC correctly notes that there is no clear meaning as to the scope and intent of section 87103. It therefore adopted a regulation which attempted to harmonize the Act with prior legislation concerning industry boards. The respondents say that the regulation is inconsistent with the very language and scope of the Act and is an attempt to undo by regulation what the voters thought they had enacted by initiative in 1974. **The fundamental question is whether the PRA should be read to nullify the many state and local laws establishing regulatory boards and commissions whose members are drawn from the very industry, trade or profession regulated. We do not believe the Act intended to do this."** [Emphasis added.] (*Consumers Union of U.S., Inc.* v. *California Milk Producers Advisory Bd., supra,* 82 Cal.App.3d at p. 444.)

Subsequently, the Commission issued *In re Overstreet* (1981) 6 FPPC Ops. 12. In *Overstreet* the Commission found that the "public generally" exception for appointed

boards and commissions allowed the landlord[3] member of a rent stabilization board to participate in some decisions where he would otherwise have a conflict of interest. Discussing the exception the Commission stated as follows:

> "The Political Reform Act addresses the integrity of governmental processes, not the content of government programs. It does not make the furtherance of a particular industry an impermissible legislative motive, either as the sole reason for setting up a particular program or as one of many reasons. In doing this, the legislative body has made a determination that the public interest coincides with the interests of the industry, and thus when a representative of that industry acts to benefit the industry, there is no conflict of interests." (*In re Overstreet, supra,* 6 FPPC Ops. 12.)

The Commission went on to find that the enabling legislation for a rent stabilization board implicitly met the requirements of the regulation, even though it did not contain the express legislative findings required under the regulation.

The perceived need to broaden the exception beyond its literal terms can be traced to the legislative evolution under which specialized boards and commissions were now being used as a tool to deal with complex broad based issues, as opposed to the more parochial issues associated with the traditional industry, profession, or trade boards.[4] This evolution is further illustrated by the make-up of the board at issue in *Overstreet*[5] which included tenant and landlord representatives, who quite certainly did not have the same commonality of interests as members of the classic industry, trade or profession regulatory bodies that originally gave rise to the exception. Notably, the Commission was sharply divided in *Overstreet,* just as it was in *Callanan.*

Advice Letters

To this day, staff has continued to wrestle with hard choices posed by this exception in numerous advice letters. In this context, the competing policy considerations have resulted in varying analytical approaches, under which the exception is construed broadly or narrowly. Generally speaking, under the broad approach, the spirit and intent of the exception prevails over a literal reading of its requisites. Under the narrow approach, there is a strict and more literal application of the requisites of the exception. Attached as Appendix C is a chronological collection of synopses of advice letters applying the exception over the last 15 years.

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3. In *Overstreet,* the Commission also applied the "public generally" exception to the tenant board member's participation in decision-making, but did not rely on the variant of the exception for appointed boards and commissions. (See also *In re Ferraro* (1978) 4 FPPC Ops. 62.)

4. Indeed, at the time of the decision in *Consumers Union of U.S., Inc.* v. *California Milk Producers Advisory Bd., supra*, 82 Cal.App.3d 433, 447 [147 Cal.Rptr. 265], according to a Commission staff survey there were only some 92 state boards that might be affected by the regulation. (*Id*. at p. 438.)

5. Regulation 18707.9 addresses some of the issues raised in this opinion regarding landlord/tenant issues.

A review of these letters reveals that staff has gone back and forth between broad and narrow applications of the exception. While there has been an overall trend towards applying the exception where a given board or commission does not meet the express requisites of the exception, this appears to be attributable more to the increasing use of specialized boards and commissions as a legislative tool to address complex issues than to any sort of propensity towards a broad interpretation of the exception. It is really this evolution of sophisticated issue-oriented legislation that has driven the development of the exception.

Regulation 18707.4—The Debate Continues

The current manifestation of this issue before the Commission is little different than it was over 25 years ago when the exception was first enacted by the Commission. How far, if at all, can the Commission go in accommodating the purposes of the various types of legislation establishing these appointed boards and commissions to ostensibly provide specialized service to the public without fundamentally compromising the purposes of the conflict of interest provisions of the Act?

The "public generally" exception for appointed boards and commissions is now embodied in Regulation 18707.4 which states:

> "(a) For the purposes of Government Code section 87103, the "public generally" exception applies to appointed members of boards and commissions who are appointed to represent a specific economic interest, as specified in section 87103(a) through (d), if all of the following apply:
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> "(1) The statute, ordinance, or other provision of law which creates or authorizes the creation of the board or commission contains a finding and declaration that the persons appointed to the board or commission are appointed to represent and further the interests of the specific economic interest.
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> "(2) The member is required to have the economic interest the member represents.
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> "(3) The board's or commission's decision does not have a material financial effect on any other economic interest held by the member, other than the economic interest the member was appointed to represent.
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> "(4) The decision of the board or commission will financially affect the member's economic interest in a manner that is substantially the same or proportionately the same as the decision will financially affect a significant segment of the persons the member was appointed to represent.
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> "(b) In the absence of an express finding and declaration of the type described in Title 2, California Code of Regulations, section 18707.4(b)(1), the 'public generally' exception only applies if such a finding and declaration is implicit,

> taking into account the language of the statute, ordinance, or other provision of law creating or authorizing the creation of the board or commission, the nature and purposes of the program, any applicable legislative history, and any other relevant circumstance."

The regulation no longer uses the terms "industry, trade or profession" as did its seminal predecessor of some 25 years ago, it uses the generic term "economic interest." However, notwithstanding this more generalized language, the regulation still reflects the narrowness of its roots. Members must still be expressly required to have an economic interest and act in furtherance of that interest under the enabling statute. Most certainly, the exception does not address statutory schemes in which something other than an economic interest is the basis for the appointment. In short, the exception cannot be applied as written to increasingly complex pieces of legislation without undue interpretation by staff in advice letters. This lack of flexibility is what has brought this issue back to the forefront for Commission consideration.

Attached as Appendix D is a copy of a letter from the L.A. Care Health Plan (L.A. Care). As can be seen from its letter, it has had significant problems with the language of the regulation. While L.A. Care has received some direction by way of an advice letter, it is clear that the requirement that a commission member "have the economic interest the member represents" will continue to be problematic. (*Dorsey* Advice Letter, No. I-01-102 attached as Appendix E; see also Appendix C.)

Other changes suggested by L.A. Care include eliminating the "and further the interests" requirement since this requirement appears redundant to the "to represent" language. Finally, because there are now several "significant segment" standards, in order to simplify the language, L.A. Care has suggested the inclusion of a self contained "significant segment" standard within the regulation applicable to these types of boards and commissions. The proposed changes are narrowly focused on the L.A. Care situation and would only serve to firm up uncertainties that remained unresolved after the *Dorsey* Advice Letter. However, the proposed changes would have application beyond L.A. Care as an entity, but would not represent a marked change in the flexibility with which the exception can be applied, as compared with current advice.

Before the L.A. Care situation arose, staff considered some of the broader issues with the regulation as a part of Phase 2 of the Conflict of Interest Regulations Improvement Project. However, the difficulty in balancing the competing interests and the lack of a consensus on the appropriate approach prevented the issues from being addressed in that context. With the L.A. Care predicament and the other above discussed issues that continue to arise as to the appropriate scope of the exception, staff is seeking direction as to the Commission's policy position.

The rationale for broadening, or otherwise increasing the utility of the regulation, is really no different than what was stated long ago. The Act should not nullify the content of other pieces of legislation establishing specialized boards and commissions to grapple with the complex issues of modern government. The membership of these

appointed boards and commission is made up of persons, who in the judgment of the legislative body have the necessary specialized knowledge, expertise, or background, to best deal on an ongoing basis with the certain issues of government. The conflict of interest provisions of the Act should not be used to prohibit their participation in making the very decisions for which they were selected. The L.A. Care situation is a perfect example of a legislative judgment having been made to have persons with certain specialized knowledge making complex decisions regarding the provision of health care services. The Act ends up thwarting the needed participation of the persons who are best suited to make these complex decisions. As eloquently stated by the Commission in discussing these types of legislative judgments in *Overstreet*: "In doing this, the legislative body has made a determination that the public interest coincides with the interests of the industry, and thus when a representative of that industry acts to benefit the industry, there is no conflict of interests."

The counterpoint against broadening the exception also presents substantial policy considerations for the Commission. There is a substantial difference between an exception that only applies to boards and commissions that regulate a single industry, trade, or profession, and one that may be applied to any appointed board or commission, regardless of its jurisdiction. Conceivably, this could lead to the creation of unlimited numbers of boards or commissions that are for all intents and purposes exempt from the conflict of interest provisions of the Act. For example, a city or county could establish a local finance commission and designate that some of its members must be persons who represent "corporate and governmental finance and investment."[6] A broadened regulation could allow such a commission member to make decisions directly benefiting his or her corporate investments. Any broadening of the regulation presents a real danger that the conflict of interest provisions will be undermined to the detriment of ethical government.

The competing policy considerations can be summed up as follows: Should the regulation be amended to provide greater flexibility in accommodating the evolving types of legislation creating these boards and commissions, or should the status quo be maintained to prevent the danger of legislative circumvention of the conflict of interest provisions of the Act?

As this is classic policy debate for the Commission itself, staff is presenting to the Commission two decision points for consideration.

Decision Point 1: Should the regulation be amended?

Decision Point 2A: If the Commission determines that the regulation should not be amended, what is the appropriate interpretive approach to the current regulation?

6. Indeed the County of Los Angeles has established one such commission with this as one of the requisites for membership.

Option A: Staff would continue as it has, addressing issues under the regulation on a case by case basis applying the regulation in accordance with previous Commission opinions and advice letters.

Option B: Staff would continue to address issues under the regulation on a case by case basis, but would pull back from some of the broader interpretations given to the regulation in previous advice letters and apply a narrower construction to the regulation limiting its application to bodies which clearly meet all of the requisites of the regulation.

Decision Point 2B: If the regulation is to be amended, what is the appropriate approach?

Option A: Staff would present amendments to the regulation dealing with situations as they arise and narrowly tailoring any amendments to deal with the specific situation at hand.

Option B: Staff would present a full range of amendments allowing for application of the exception to other legislatively created bodies that would not otherwise meet the current criteria of the regulation.

Option C: The Commission would seek legislative resolution of the matter through an amendment to the Political Reform Act, if such an amendment were drafted to further the purposes of the Act.

Staff Recommendation: Staff is making no recommendation as to the fundamental policy issue as set forth in Decision Point 1, as that is the issue for Commission resolution. However, staff recommends against adoption of Option C of Decision Point 2B, in that if this matter is referred to the legislative process, the Commission may not be able to keep the scope of such legislation narrow. Moreover, the other issues presented in Options A and B of Decision Point 2B would still need to be addressed to determine the content of any legislative proposal. Staff believes that the Commission has a sufficient reservoir of administrative discretion under the Act to address this issue without resort to the legislative process.

Appendices:
A. *In re Callanan*
B. *Consumers Union of United States, Inc.* v. *California Milk Producers Advisory Board*
C. Chronological Collection Of Synopses Of Advice Letters
D. L.A. Care's Letter
E. *Dorsey* Advice Letter, No. I-01-102